

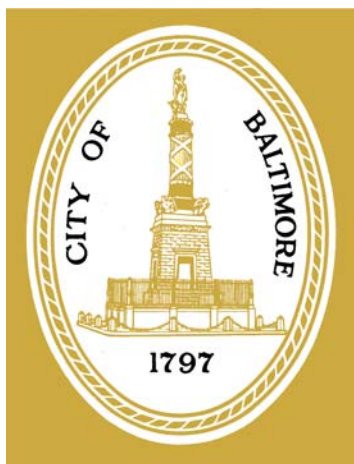
PERFORMANCE AUDIT REPORT

CITY OF BALTIMORE

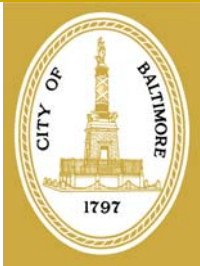
DEPARTMENT OF FINANCE - PURCHASES

INVENTORY CONTROL

AUGUST 2003



City of Baltimore
Department of Audits



August 12, 2003

Honorable Joan M. Pratt
And Other Members of the Board of Estimates
City of Baltimore

The Department of Finance - Bureau of Purchases (Purchases) requested that the Department of Audits observe the physical counting of inventory stored in Warehouse No. 15 on January 31, 2003 and perform a review of the applicable procedures for inventory control and the management of warehouse inventory operations. This report conveys the results of our audit.

BACKGROUND

The City of Baltimore established warehouses that stock standard material and supplies for use by City agencies. The warehouses, which are operated by Purchases, provide an efficient, cost-effective method for purchasing large quantities of common materials and supplies at low-dollar, volume-discounted prices for use by multiple City agencies. Using the Warehouses improves delivery time of these items to City agencies. Warehouse No. 15 services all City agencies as well as the Baltimore City Public School System (Education). Costs associated with operating an inventory warehouse are recovered from Education and the City agencies that benefit from the services provided. Charges for this service include the moving average cost of the item plus 5.5%.

At one time Purchases operated ten warehouses but currently is responsible for only two. Warehouse No. 15, staffed with eight warehousemen including the Warehouse Supervisor, stocks approximately 541 inventory items. Warehouse No. 15 inventory includes items such as bond paper and various paper forms, safety products, janitorial supplies, health and medical supplies and various paints. During the period from July 1, 2002 through May 31, 2003, the warehouse received 4,119 agency requests for inventory and filled (pickup or delivered) 5,460 orders. For the same period, the warehouse received 542 Education requests for inventory and delivered 1,220 orders. According to the inventory taken on January 31, 2003, the value of Warehouse No. 15 material and supplies totaled \$1,236,000.

OBJECTIVES, SCOPE AND METHODOLOGY

The objectives of this audit were to determine the accuracy of the inventory count taken on January 31, 2003 and to determine if the City's internal controls were adequate to safeguard assets and ensure that all inventory receipts and withdrawals were properly recorded in both the perpetual inventory and accounting records. Our audit was conducted in accordance with generally accepted *Government Auditing Standards* related to performance audits, issued by the Comptroller General of the United States and accordingly, included such tests of the accounting records and other such auditing procedures we considered necessary in the circumstances.

In order to accomplish our objectives, we observed the physical inventory taken by Purchases on January 31, 2003 and performed independent counts of inventory items on a test basis and reconciled our counts to Purchases' records. We also reviewed Purchases' reconciliation of the actual count to the perpetual inventory records maintained by the Bureau of Accounting and Payroll Services for reasonableness and determined that the adjustments were made to the perpetual inventory records. Additionally, we obtained an understanding of the policies and procedures used to control the City's perpetual inventory system and evaluated their adequacy. We tested inventory transactions to determine whether the policies and procedures were in place during the period July 1, 2002 through May 31, 2003. The results of our audit are detailed in the Findings and Recommendations section included in this report.

FINDINGS AND RECOMMENDATIONS

The physical inventory count was reconciled to the perpetual inventory records by Purchases and initially resulted in an unreconciled difference totaling \$1,135,449. After either recounting or reviewing the histories of the inventory for the past 13 months, \$920,508 of the \$1,135,449 difference was identified by Purchases, bringing the final difference to \$214,941. This remaining difference could not be explained. On March 3, 2003, the City Purchasing Agent approved the adjustment to perpetual inventory records to agree them to the physical inventory count. Purchases did not reconcile the perpetual inventory records to the City's general ledger. Therefore, the City's general ledger has not been adjusted.

Based upon our testing of the inventory requisitioning and billings, we determined that the policies and procedures were adequate to ensure that City agencies and Education were properly charged for inventory withdrawals. However, our audit noted several areas where the accounting and management of the warehouse inventory can be enhanced to operate efficiently and effectively.

Finding # 1**Periodic inventories were not performed on a scheduled basis.****Analysis**

Periodic inventory counts of items stored in Warehouse No. 15 were not routinely performed. The last inventory at Warehouse No. 15 was performed approximately six years ago. Since that time, Purchases has consolidated the City's inventory into two warehouses and has discontinued the practice of scheduling periodic inventories and reconciling actual stock counts to the City's perpetual inventory records and general ledger. Without periodically scheduled inventories and reconciliations to the inventory records and general ledger, inventory shortages and overages could occur and remain undetected.

Recommendation

We recommend that Purchases schedule and perform periodic counts of the warehouse inventory and reconcile the inventory counts to the perpetual inventory and accounting records.

Finding #2**Responsibility for monitoring the financial activities of the Warehouse operations was not clearly defined.****Analysis**

Purchases did not adequately monitor the warehouse inventory activities. With the downsizing of the inventory control division, Purchases did not reassign oversight responsibility for the warehouse operations, leaving the warehouse and the remaining inventory control personnel to operate independently. Although the current inventory system is capable of ensuring that all inventory receipts and withdrawals are recorded, this system is a combination of automated and manual processes that is labor intensive and prone to errors. The effect of the lack of oversight is best demonstrated by the fact that the perpetual inventory records initially did not reconcile to the actual inventory count. This difference was in excess of a million dollars. Purchases recognizes the need for a fully automated system and is in the process of procuring an automated requisitioning (including warehouse requisitions) system. According to Purchases, the implementation of this system will fully automate the inventory system and provide information on the status of each requisition, an on-line perpetual inventory records, editing screens for use by inventory and accounting personnel, and timely inventory balances and reports.

We recommend that Purchases establish adequate oversight of the warehouse operations by assigning oversight responsibilities to specific personnel. These duties should include responsibility for ensuring that all inventory and related accounting records are accurate and complete. We also encourage Purchases to continue its

effort to fully automate the entire inventory system from the time the requisition is initiated by the agency until the goods are delivered. This new system should also be fully integrated with the City's accounting system. An automated system will provide management access to the status of outstanding orders and to more timely information regarding inventory balances. This information will enable management to more closely monitor inventory activities and to react timely to changes in overall City inventory needs. We further recommend that Purchases explore the possibility of making the new requisitioning system available to City agencies through the City intranet system. Using the City's intranet system as a delivery tool will make the system more widely available for agency use and may decrease system implementation time since all City agencies already have access to the City's intranet system.

Finding #3

Purchases did not have policies and procedures for identifying and disposing of obsolete inventory items.

Analysis

Purchases did not have established policies and procedures for addressing inventory obsolescence. On January 31, 2003, we observed a number of items that appeared to be obsolete. We also observed printed forms and material that are no longer used by the City or Education. The lack of policies and procedures for identifying and disposing of obsolete inventory increases City costs for storage and maintenance and ultimately reduces any recoveries the City may obtain when the items are disposed.

Recommendation

We recommend that Purchases establish policies and procedures that address the identification of obsolete inventory and its subsequent disposition. At a minimum these policies and procedures should define obsolescence and establish clear responsibilities within Purchases for the enforcement of those policies and the ultimate disposition of the obsolete items.

Finding #4

Purchases did not perform periodic reviews of its reorder points to determine whether inventory levels were adequate.

Analysis

Purchases did not perform periodic reviews of inventory-reorder points. The current inventory stock level reorder points were established over 20 years ago. Since then, Purchases has not evaluated the reorder points to determine whether inventory levels are adequate to meet City demands while preventing excess inventory level and shortages. When the inventory supply is insufficient, Purchases must make emergency buys or agencies may purchase the items themselves without the benefit of volume discounts. These practices may not result in the most economical procurement.

Recommendation

We recommend that Purchases establish procedures that require periodic evaluations of the inventory reorder points. These procedures should include an evaluation of required stock levels based on agency needs and lead times required to procure the items. If shortages do occur, Purchases should investigate the reasons for the shortages and adjust reorder points accordingly.

Finding #5

Purchases did not maintain an “up to date” inventory catalog.

Analysis

The inventory catalog was not maintained on a current basis. The last printing of the City’s inventory warehouse catalog was approximately 6 years ago. Since that time, the City has implemented “just in time” purchasing from a vendor, and many of the supplies that agencies previously obtained from the warehouse are now supplied by a vendor. Use of the outdated catalog causes requisitions to be completed incorrectly, increasing the time and cost required to fill agency requests.

Recommendation

We recommend that Purchases update its warehouse catalog. Additionally, policies should be developed and implemented that require the inventory catalog to be updated annually.

Finding #6

Clear lines of responsibilities for operation of the warehouse have not been established between the City and Education.

Analysis

Lines of responsibilities between the City and Education for the operations of the warehouse have not been clearly established. Warehouse No. 15 has approximately 38,400 square feet of space of which 16,800 square feet is utilized by Education’s Nutrition Program with the remainder being used by the City. No formal agreement exists that outlines responsibilities related to the maintenance, repairs and modifications to the Warehouse. Disputes between the parties have arisen regarding the allocation of space and the modification of the existing structure.

Recommendation

We recommend that the City and Education implement an agreement that clearly defines the responsibilities of both parties. This agreement should detail the footage and location of space allocated to Education. Maintenance responsibilities at the facility should be clearly defined, and the agreement should also include the necessary approvals required before modifications can be made to the existing structure.

Finding #7

The overhead reimbursement rate charged on inventory purchases has not been reviewed.

Analysis

The overhead reimbursement rate charged by Purchases on inventory items has not changed in over 10 years. During this ten-year period, the City's salaries, fringe benefits and other related costs have increased. Additionally, changes in the size and nature of the City's warehouse operations could have affected costs. Based on our inquiries with Purchases, the City does not routinely review the reimbursement rate charged. Without this periodic review, inventory overhead cost could exceed the reimbursement rate.

Recommendation

We recommend that Purchases, in conjunction with the Bureau of Accounting and Payroll Services, evaluate the City's current overhead rate to determine if all operating costs are being recovered.

Finding #8

The inventory warehouse area was not clean and organized.

Analysis

Purchases did not maintain a neat, clean and organized warehouse. Improvements are needed in the areas of general housekeeping, physical layout of inventory, and maintenance. We observed that inventory items were not always consistently labeled with inventory numbers nor were they stored in an organized manner that would facilitate their efficient retrieval. The facility was also in need of painting and better lighting. Surplus property that appeared to be damaged or obsolete was located in the center of the first floor. The poor organization of the inventory and the lack of proper lighting and storage of inventory items could lead to safety and fire hazards and hinder the efficient operation of the warehouse.

Recommendation


We recommend that Purchases organize the warehouse in a manner that facilitates efficient, safe and timely retrieval of stock items. Steps should also be taken to clean up the warehouse and, where necessary, lighting and other improvements should be made to ensure the safe and efficient use of the facility.

The Department of Finance – Bureau of Purchase’s response to our audit is included as an attachment to this report.

We appreciate the cooperation and assistance provided by the staff members of the Department of Finance – Bureau of Purchases.

Respectfully submitted,

Yovonda D. Brooks, CPA
City Auditor

FROM	NAME & TITLE	Edward J. Gallagher, Acting Purchasing Agent	CITY of BALTIMORE MEMO	
	AGENCY NAME & ADDRESS	Bureau of Purchases 231 E. Baltimore Street (410) 396-5700		
	SUBJECT	AUDIT REPORT - INVENTORY CONTROL REQUEST FOR RESPONSE TO REPORT		

DATE:

TO Ms. Yovonda D. Brooks, City Auditor
Department of Audits
City Hall, Room 321

August 8, 2003

Dear Ms. Brooks:

Clement Ruley's memo of July 21, 2003 requested a written response of planned corrective action regarding the draft report of the audit of Bureau of Purchases, Inventory Control, Warehouse 15.

First, a general comment. The Background section of the audit report asserts that warehousing is an efficient and cost effective means of purchasing and delivering large quantities of materials and supplies. Although this was almost always true in the past, and still is for some items, recent trends in procurement have been away from warehousing in favor of "just in time" requirements contracts. These contracts are often more efficient when the total cost of warehouse overhead and delivery are considered, along with the cost of the inevitable shrinkage, spoilage, and obsolescence of inventory stock. For these reasons the Bureau of Purchases has in recent years closed eight of its ten warehouses, and is examining the items stocked in its remaining two to determine which items should be retained and which replaced by requirements contracts.

That said, our planned corrective actions follow, keyed to the findings in the draft audit report.

FINDING 1. Periodic inventories were not performed on a scheduled basis.

Concur.

Inventories of both Warehouse 15 and Warehouse 1 will be conducted annually at the end of each fiscal year.

FINDING 2. Responsibility for monitoring the financial activities of the Warehouse operations was not clearly defined.

Concur.

Purchases has just completed a reorganization which now clearly defines the responsibility for oversight of warehouse operations, including financial activities, beginning with the Warehouse Supervisor, through the Inventory and Administrative Services Supervisor and the Assistant City Purchasing Agent, to the City Purchasing Agent.

The report points out the need for a modern automated inventory system to replace the current system, which is a mix of automated and manual processes, and says that

Purchases is procuring such a system. In fact, no follow-on system has been decided upon. The requisition processing system currently being procured (ComPASS) will automate the warehouse requisition process to some degree, but will not be a comprehensive inventory control system. Candidate systems under consideration include one currently used by the Police Department, and perhaps a follow-on enhancement to the ComPASS system, but a long-term solution is not anticipated to be in place for a year or more. In the meantime, our plan is to reinvigorate and streamline the warehouse operation using improved workflows with the current computer system which, despite its antiquity, performs adequately if properly used. Expected completion: January 2004.

FINDING 3. Purchases did not have policies and procedures for identifying and disposing of obsolete inventory items.

Concur.

Purchases will establish procedures for identifying obsolete inventory items which will rely primarily on usage history, and which will occur at regular intervals. We have a start in gaining visibility in this area through our CitiStat reporting which points out slow moving items. However, as the audit showed, our tracking of warehouse inventory has been poor in recent years and we therefore have little confidence that we know where we stand in that regard. Once we put in place accurate tracking procedures (see Finding 2) we will be ready to tackle this item. Disposal of excess inventory will be in accordance with Administrative Manual procedures for surplus property. Expected completion: June 2004.

FINDING 4. Purchases did not perform periodic reviews of its reorder points.

Concur.

Although reorder points have not been adjusted in the system for many years, Purchases does not reorder based solely on what the system says is needed. When a buy order is generated by the system, it is always reviewed by the buyer who may adjust it upward or downward, depending on recent usage experience. We agree, however, that it would be more efficient to build this knowledge into the system by periodically revising the reorder points and will do so, including examining each case of shortage for reasons and remedies. Expected completion: January 2004.

FINDING 5. Purchases did not maintain an up-to-date inventory catalog.

Concur.

With the implementation of the Just-In-Time contracts vendor catalogs were supplied to all City agencies by the successful vendors. The catalog for the remaining items left in the City warehouse was not kept up to date. Responsibility for updating the catalog has been assigned to the current warehouse management (see Finding 2). Expected completion: December 2003.

FINDING 6. Clear lines of responsibilities for operation of the warehouse have not been established between the City and Education.

Concur.

A proposed agreement setting forth Rules & Regulations for Warehouse #15 was submitted to BCPS for comment in April. (Copy attached). Expected completion: December 2003.

FINDING 7. The overhead reimbursement rate on inventory purchases has not been reviewed.

Concur.

Purchases will review with BAPS the overhead rate charged to ensure that all overhead costs are recovered. Expected completion: November 2003.

FINDING 8. The inventory area was not clean and organized.

Concur.

Purchases will take immediate steps to make the warehouse cleaner and better organized in the short term. As we move toward a total overhaul of the warehouse we will develop a longer-term improvement plan for the physical plant. Expected completion: June 2004.

Cc: Clement Ruley, Audit Manager, City Hall Room 321